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AGENDA FOR PROVINCIAL-MUNICIPAL FISCAL REFORM

VLADIMIR SALYZYN

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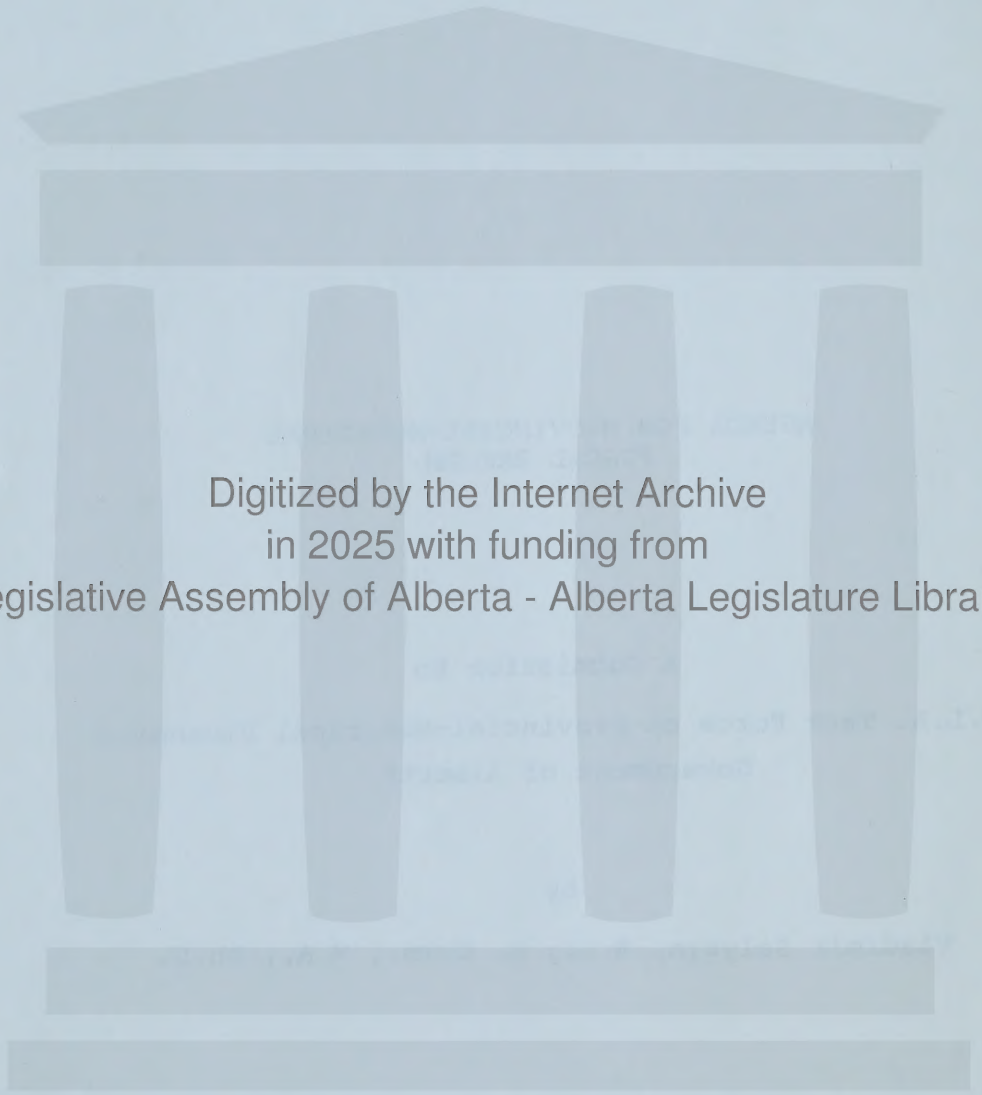
AGENDA FOR PROVINCIAL-MUNICIPAL FISCAL REFORM

A Submission to

M.L.A. Task Force on Provincial-Municipal Financing
Government of Alberta

by

Vladimir Salyzyn, B.A., B. Comm., M.A., Ph.D.



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PREFACE

Concern over the fiscal plight of municipal governments in Alberta is almost always expressed in the form of dissatisfaction with the property tax. For some, this simply means that the government is spending too much; for others, it means that the government is spending its revenues inefficiently; for still others, the concern is with the nature of the property tax, the availability of alternative revenues, and the types of services that should be financed by local funds. It is my belief that it is the last of these that concerns most taxpayers in Alberta.

Although the immediate purpose of this submission is to recommend some alternative approaches to solving the fiscal problems of municipalities in Alberta, I was guided by much broader principles. As a result, my submission is disposed to deal more with general long-run solutions than with presenting a blueprint for immediate action. This is designed to differentiate basic revisions from patchwork solutions.

It is also my belief that your Task Force can fail to achieve its objectives equally from a misunderstanding of the underlying problems and causes as from a misspecification of the solutions. Consequently, emphasis is placed on a careful analysis of the sources of the problems. This procedure ensures that general guidelines precede detailed policy recommendations.

This submission is the second of a two-part presentation. Solutions to the fiscal problems of municipalities can be placed into one of two categories: those that aid the municipal governments in discharging their responsibilities on their own, and those that involve some form of inter-relationship with the provincial government. The former includes improvements in existing revenue structures and the development of new forms of locally imposed and administered revenue sources. The latter consists of special provincial-municipal tax sharing arrangements and the reallocation of revenue and expenditure responsibilities between two levels of government. These latter solutions are the ones discussed in this submission; the former were presented in the companion submission, Agenda for Municipal Revenue Reform.

Parts of this submission include material first appearing in The Tax Executive, Canadian Public Administration and Civic Administration.

Vladimir Salyzyn
Edmonton, Alberta, 1972

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CHAPTER I THE PROBLEMS, CAUSES AND SOLUTIONS

Introduction

Ten years ago the premier of the Province of Alberta made a policy statement that proposed "a factual study" of how public expenditures can be best "financed having regard to the legitimate needs and best interests of the people of the province as a whole". A committee of representatives was drawn from a number of important provincial organizations and from the provincial government to perform this task. In 1966, the results of their deliberations were made public in a study entitled Report of the Public Expenditure and Revenue Study Committee.

This Committee failed to achieve its goal for several reasons, but primarily because it served mostly as an apology for existing policies. The Committee lacked proper detachment and was unqualified to perform intensive expert analysis. Nor was any attempt made by the Committee to develop any cohesive scheme in line with generally accepted fiscal principles.

The patchwork solutions recommended by the Public Expenditure and Revenue Study Committee only served to postpone serious study, while dissatisfaction with the fiscal situation continued unabated. Municipal representatives almost immediately called for rational resolution of their pressing

revenue problems.[1] The government also resumed the investigation of both the property tax and the problems of financing education.[2] Unfortunately, the government again used committees much the same in structure as the Public Expenditure and Revenue Committee.

Finally, in 1971, the provincial government recognized the need for an independent, comprehensive investigation, and appointed a three-man Royal Commission. This Commission was immediately abandoned by the new Conservative government and a legislative task force was substituted in its place.

This legislative task force may be less attached to existing practices and past policies than the previous committees were, nevertheless, this task force will be seriously hampered in its work unless it takes the effort to develop sound principles and endeavours to work independently of outside pressures.

Great care must be exercised not to commit the errors made by the Public Expenditure and Revenue Committee. The Committee complained that despite "large transfer payments" and "the assumption of about 45 per cent of the cost of elementary and secondary education", and "the assumption ... of

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[1]Urban Crisis, Alberta Municipal Finance Study (Calgary: Cities of Alberta, Alberta Urban Municipalities Association and Public and Separate School Boards in Each City, 1968).

[2]Minister's Committee on School Finance, Report of the Minister's Committee on School Finance, (Edmonton: Department of Education, Government of Alberta, 1969). Report of the Special Committee Appointed by the Government of Alberta to Study Assessment and Taxation, (Edmonton, 1970).

a very high proportion of the costs of welfare, public health and hospitalization services", the municipalities "are not able to discharge their responsibilities" without difficulty. And yet the Committee recommended more of the same types of transfers of funds.[3] As explained below, this kind of solution has in fact become the problem.

The only principle that appeared in the Committee's report was "that responsibility for service should be determined by the criterion of which level of government can best perform the service".[4] Since this principle has nothing to say about which level of government is held responsible for policy decisions, it has simply ignored the main source of the problem.

The Problems

Since it is a common pitfall to assume that municipal fiscal problems are obvious and that one need only direct effort to seeking solutions, great care is taken here to identify the problems carefully and accurately.

A complete list of the more important provincial-municipal fiscal problems can be identified as belonging to one or more of the following general categories.

1) Responsibility Imbalance. The level of government that raises the revenues does not always have a corresponding part

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[3] Province of Alberta, Report of the Public Expenditure and Revenue Study Committee, (Edmonton, 1966), p. 114.

[4] Ibid., p. 114.

to play in the decision on how the money is spent. Alternatively, the level of government that spends the money may have no say on how the revenue is raised. Misallocation of resources results whenever responsibilities for expenditures are not matched by responsibilities to raise revenues for them. This problem arises whenever a junior level of government depends on financing from the senior level, and leads to the undermining of "accountability, cost control and normal priority-setting processes".[5]

2) Capacity-Obligation Imbalance. Revenues available at the local level are insufficient to provide for the expenditures expected to be undertaken at this level because revenues sources are inadequate and/or because expenditure obligations are excessive. The first of these is caused by a responsibility imbalance (number 1 above) or by fiscal inefficiency (number 4 below) or both. The second is often the consequence of a benefit-cost imbalance (number 3 below).

3) Benefit-Cost Imbalance. There exist spillovers of benefits and costs between the province and its municipalities and among the municipalities. For example, local governments are often called upon to supply public goods and services that yield benefits to those located outside their jurisdiction. In like manner, certain municipalities may create additional costs to

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[5]From a statement by a Provincial Treasurer at the 1972 finance ministers meeting in Jasper, Alberta.

those in other areas.

4) Fiscal Inefficiency. Fiscal inefficiency manifests itself most clearly in the inadequate design of local revenue structures. Inefficiency also arises from a lack of tax coordination among municipalities and the province. This latter type of fiscal inefficiency can aggravate the capacity-obligation imbalance (number 2 above) and contribute directly to a responsibility imbalance (number 1 above).

5) Horizontal Inequality. Differences in fiscal capacity among municipalities accentuate most of the other provincial-municipal fiscal problems, particularly for those governments with the lowest capacity to discharge their obligations. Fiscal capacity must be distinguished from fiscal performance which may lag behind capacity for a variety of reasons.

Some Solutions

A number of solutions to intergovernmental fiscal problems have been suggested recently by several world renown experts. Joseph A. Pechman of the prestigious Brookings Institution, for example, suggests: expansion of the local tax base by improving the property tax and adding sales and income taxes; increasing grants-in-aid; shifting welfare costs to higher levels of government; providing credits for taxes paid at the local level; increasing tax coordination between levels of government; and supplements from the federal government

during periods of unemployment.[6] To this list, Bernard P. Herber, a professor of economics, adds a negative income tax as a means of solving poverty problems at the local level.[7] Donald G. Alexander, Legislative Counsel to the National League of Cities, suggests the assumption of all local costs of welfare, education and pollution control by higher levels of government. Alexander would also like to see the consolidation of local governments and more reliance being placed on the private sector.[8]

This list may not be comprehensive enough for provincial-municipal fiscal problems in Alberta, but it offers a rather encouraging number of possible alternatives.[9] The only danger with such an extensive list is that it provides zealots an avenue for their own pet solutions, making rational choice difficult.[10]

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[6]Pechman, J.A., "Fiscal Federalism for the 1970's", National Tax Journal, September 1971.

[7]Herber, B.P., "Discussion", National Tax Journal, September, 1971.

[8]Alexander, D.G., "New Directions in Urban Financing", Annual Editions Readings in Economics '72, (Guilford: Dushkin, 1972).

[9]Another solution that can be added to the list is the changing of the BNA Act to re-assign responsibilities between the levels of government. See V. Salyzyn, "How Efficient Constitutional Re-allocation of Governmental Financing Can Help Canada Solve Pressing Urban Problems", Civic Administration, October 1970.

[10]One need only follow the local press to get evidence of this.

The following are the most logical solutions (see Table 1-1):

1) Responsibility imbalance can be corrected by minimizing the role assigned to inter-governmental grants (since these are the prime source of the problem), by improving existing municipal revenue structures and by coordinating tax revenues with the province.

2) Capacity-obligation imbalances can be solved by correcting responsibility imbalances and removing the benefit-cost imbalance.

3) The benefit-cost imbalance, in turn, can be solved only by re-assigning legal responsibilities between the province and the municipalities.

4) Fiscal inefficiency can be reduced by improving current revenue sources, by introducing new sources and by rationalizing inter-governmental tax relations.

5) Although horizontal fiscal inequality among municipalities can be solved by encouraging labour and capital migration through normal market processes, expenditure programs and grants-in-aid would be more acceptable on humanitarian and equity grounds. Grants-in-aid, however, must be limited only to those municipalities in need in order not to aggregate responsibility imbalances.

TABLE 1-1 PROVINCIAL-MUNICIPAL PROBLEMS, CAUSES AND SOLUTIONS

Problems	Main Causes	Principle Solutions
I. Responsibility imbalance	1. Grants to municipalities 2. Inefficiency (Problem IV)	a. Improve revenue structures b. Minimize use of grants c. Coordinate taxes with province
II. Capacity-obligation imbalance	2. Inefficiency (Problem IV) 3. Benefit-cost imbalance (Problem III) 4. Responsibility imbalance (Problem I)	a. Improve revenue structures b. Minimize use of grants c. Coordinate taxes with province d. Correct misallocation of responsibility among levels of government
III, Benefit-cost imbalance	5. Misallocation of responsibility among levels of government	d. Correct misallocation of responsibility among levels of government
IV. Fiscal inefficiency	6. Inadequate local revenue structure 7. Poor tax coordination with province	a. Improve revenue structures c. Coordinate taxes with province
V. Horizontal inequality	8. Regional economic disparities	e. Grants-in-aid (conflicts with solution b) f. Regional expenditure programs

The list of principle solutions is as follows (see Table 1-1):

a) Improve municipal revenue structures.

b) Minimize use of grants.

c) Coordinate taxes with province.

d) Correct misallocation of responsibility among levels of government.

e) Grants-in-aid (conflicts with solution b).

f) Regional expenditure programs.

Solution a, the improvement of municipal revenue structures, was discussed in the companion submission, Agenda for Municipal Revenue Reform. Chapter II sets out the framework for evaluating provincial-municipal tax sharing schemes and Chapter III investigates the feasibility of shared income, sales and value-added taxes. Chapter IV discusses the misallocation of responsibility among levels of government and examines the use of grants. The final chapter, Chapter V presents some recommendations dealing with solutions b to e inclusive.

Solution f, regional expenditure program, is beyond the scope of either of these submissions.

CHAPTER II PROVINCIAL-MUNICIPAL TAX SHARING SCHEMES[1]

Introduction

The purpose of this chapter is (1) to make a clear theoretical and practical distinction among the alternative forms of tax sharing arrangements, (2) to examine some current provincial-local (and state-local) sharing arrangements, and (3) to evaluate the alternative schemes. Suggestions for some practical applications are made in the next chapter.

Tax sharing arrangements can provide an opportunity for two levels of government to co-ordinate the administration collection, and/or distribution of tax revenues to their mutual advantage. Taxes involved in this type of fiscal scheme generally have one of two characteristics — they either can not be administered by the local government or they can be administered by the local government most effectively only by means of some type of senior government involvement. The taxes involved would also, of course have to be acceptable to their own right. The economic consequences of any tax used would have to be favourable and the yield would have to be adequate. The tax would also have to be one that did not generate any undesirable inequities.

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[1]Parts of this chapter use material previously published in The Tax Executive and in Canadian Public Administration.

Characteristics of Tax Sharing Arrangements

Although the emphasis here will be on provincial-municipal arrangements, the analysis developed is directly applicable to state-local or any other shared tax arrangement between two levels of government. The typical scheme involves a transference of tax funds from the province to the local government. It is not inconceivable, however, that this flow may be in the reverse direction. A case in point was the local collection of the amusement tax in Quebec, the revenue of which was shared.

A clear distinction must be made between tax sharing arrangements discussed here and other forms of provincial-local financial co-ordination. It is also desirable to define the precise differences that characterize each of the various forms of tax sharing arrangements.

To begin with, tax sharing arrangements must be explicitly differentiated from grants. Any unconditional transfer of tax funds from the province to the local unit made according to the jurisdictional source of the revenue is a tax sharing arrangement. The amount transferred could be any fraction of the amount collected within the municipality.

The existence of a shared tax can be identified by the act of any municipality receiving unconditionally all or any fraction of a tax collected within its boundaries by the province under an arrangement which involves some kind of provincial-municipal co-ordination. Provincial participation may range from mere collection of the tax to the complete

control and administration of it.

A grant on the other hand, involves the shift of provincial revenues to local governments on any basis other than the proportion of such funds obtained from within the municipality. Grants are usually distributed on a "need" basis according to a prescribed formula and are often provided for specific expenditure purposes. There are formulae, however, which include factors only remotely connected with need; for example, highway grants which are correlated directly with property assessment. In addition, provincial grants paid to local governments may be financed from non-tax revenues or borrowed funds.

A transfer of funds, having otherwise all the characteristics of a tax sharing arrangement, would have to be definitionally classified as a conditional grant if any reservations were attached to the manner in which the funds could be used. On the other hand, an unconditional "grant" paid to each municipality in proportion to the amount of specific tax revenues collected within its boundaries is defined as a shared tax and not a grant.

Tax sharing arrangements may take any of three forms: locally imposed and provincially administered taxes; supplementary tax rates; and, shared tax revenues. Table 2-1 identifies purely independent municipal and provincial taxes and differentiates schematically among the three forms of shared tax arrangements according to which level of government

TABLE 2-1

SHARED TAX ARRANGEMENTS

	Independent Municipal Tax	Locally Imposed Provincially Administered	Supplementary Tax Rates	Shared Revenues	Independent Provincial Tax
Who Receives Revenue	Municipality	Municipality	Municipality	Municipality	Province
Who Imposes Tax	Municipality	Municipality	Municipality	Province	Province
Who Determines Characteristics	Municipality	Municipality	Province	Province	Province
Who Administers Tax	Municipality	Province	Province	Province	Province

administers the tax, determines its characteristics, imposes the levy, and receives the revenue.

Under locally imposed and provincially administered tax arrangements each local government has full and complete discretion in deciding whether to impose the tax or not. The tax is strictly local in all respects except for the fact that it is administered by a provincial agency. The base of the tax need not be the same as that of a similar provincial tax levied for its own purposes. In fact, the tax need not exist on the provincial level at all. Nor must the tax be identical to other local taxes in the same field. However, for practical reasons the municipality imposed tax will most likely be similar or identical to other taxes already employed.

Under this scheme the local government, in effect, hires the province, or one of its agencies, as its administrator. The local unit is motivated by the fact that the machinery of the experienced provincial agency is bound to be more efficient than that existing at the local level.

The second form of shared tax arrangement is the supplementary tax rate scheme. A tax involved under this arrangement, as contrasted to the locally imposed and provincially administered tax, must first exist on the provincial level. The province then offers to supplement its own tax rate for the benefit of any local unit which desires it. The supplementary levy is usually uniform and the proceeds are distributed to the local governments in proportion to the

amount collected within the geographic boundaries of the municipalities involved. The decision to set supplementary rates is the decision of the province although the municipalities would likely be consulted before any decision was made. The tax base used is the one developed by the province for its own purposes. The only decision left to be made by each local governmental unit is whether to participate in this form of arrangement or not.

The third form of shared tax arrangement is the sharing of tax revenues. Under such an arrangement the province makes all the decisions. The tax is imposed by the province and administered by it. A portion of the total tax revenue is distributed to the municipalities according to the relative amounts collected within the confines of each municipality. The individual municipality is not given any choice once the plan is put into effect. The province simply transfers the prescribed revenue to local coffers. It is unlikely, however, that the province would enter into a shared revenue arrangement without prior consultation with the municipalities.

Current Tax Sharing Arrangements

Not many examples of locally imposed and provincially administered tax arrangements currently exist.

At one time the province of Quebec administered local retail sales taxes. This was the first arrangement of its type to be used on the North American continent.

Initially, the local retail sales tax was introduced by the City of Montreal in 1935. The City of Montreal administered its own sales tax for a period of five years until the province imposed its retail sales tax and agreed to administer all local sales taxes in the province. This introduction of provincial administration attracted many new local sales taxes in Quebec after 1940.

Each local government was permitted to decide for itself whether to use the sales tax or not. Each municipality levying a sales tax could, of course, collect the tax for itself, but since it was assured that the revenue collected within its boundaries by the province would be returned to it, it was an easy step to accept provincial administration. Provincial collection was a major factor in the rapid spread of local sales taxes in Quebec.

The tax base was nearly the same for the province as it was for each of the municipalities. The typical exception did not extend beyond the inclusion or exclusion of an additional sales item. One major difference, however, was that sales for delivery beyond the boundaries of a given local taxing jurisdiction were not subject to its municipal sales tax.

The province did not return tax receipts directly to each municipality located in the metropolitan areas of Montreal and Quebec. The sums collected were distributed to the various municipalities on a population basis. As previously

defined, this portion of the tax scheme must be viewed as a form of grant.

There is a tendency for taxes imposed locally and administered by the province or state to gradually take the form of supplementary tax rate arrangements. This takes place because there are strong administrative incentives to create identical bases for both levels of government. As soon as the development evolves to the stage where both bases are identical, both taxes are usually under the administration of the province or state. This creates an arrangement identical to that of supplementary rates. The line between a locally imposed, provincial administered tax and a supplementary tax rate is crossed when the local units are no longer permitted by statute or regulation to use a base that deviates from the provincial base.

Many of the taxes that were intended to be locally imposed and state administered in the United States have in fact ended up as supplementary tax rates. An example is the local sales tax in the state of California. From 1945 to 1955 all local sales taxes in California were administered locally. In 1955, legislation was passed authorizing state administration on a uniform basis. Although no local government was forced to levy a sales tax whose base coincided with that of the state sales tax, such action forfeited its opportunity to take advantage of state administration. Each conforming city or county had to use the specified rate and base, and was required to contract for collection with the State Board of Equalization.

This approach left no practical alternative for any city or county wishing to introduce a local sales tax. The only decision left to the local unit was whether to join the prescribed scheme or not. By 1962 all California counties had adopted the uniform sales tax. The cities soon followed.

All sales within the state of California are presumed to be made at the place where the retailer is located.

The state charges a fee for its collection services that approximates actual costs of administration.

The situation that evolved in California could have been attained by the state simply announcing that it was henceforth prepared to supplement its retail sales tax rate by one per cent for the benefit of any local government that wishes it, the tax proceeds to be distributed according to origin. This was the procedure followed by the state of Illinois where local use of sales taxes was prohibited. The state of Illinois simply declared that it was prepared to supplement its retail sales tax rate by ½ of one per cent to be returned to the place of collection for any local governmental unit requesting it. A charge for the service was levied at six per cent of collections.

The sales tax arrangements in Quebec bordered closely to that of supplementary tax rates. Had all the municipal tax bases been required to coincide with the provincial base, and had all the provincial sales been taxable

at the location of the retailer rather than at the residence of the purchaser, there would have been no difference between the arrangement and a supplementary tax rate scheme. Quebec's scheme, however, evolved into a purely provincial sales tax with a grants system designed to substitute for local sales tax revenues.

There does not appear to be a Canadian illustration of any province sharing tax revenues with its municipalities except for the case of the amusement tax in Quebec. At one time the revenue obtained from the 10 per cent amusement tax was divided on a 50/50 basis between the province and the municipality. The tax was collected by the municipality. Now the revenue belongs entirely to the municipality.

Several states in the United States share their income tax revenues with local governments. The state of Wisconsin uses shared tax revenue arrangements to a greater extent than any other state in the United States. Among several other tax revenues, Wisconsin shares its income tax collections with local governmental units. The state keeps 40 per cent of the income tax revenues, gives 10 per cent to the countries, and 50 per cent is given to the municipalities.

Evaluation of Shared Tax Arrangements

Any evaluation of provincial-municipal or state-local shared tax arrangements must take into account not only current experience with such plans but also the alternative

tax programs that could have been used. This type of broad appraisal will in some cases produce only generalized observations of a theoretical nature. Nonetheless, such an analysis can yield useful guides for policy decisions.

The following arguments in favour of shared tax arrangements are not meant to be exhaustive. They represent general statements that can be made in behalf of shared tax arrangements as a whole. Arguments in favour of the desirable characteristics that apply more specifically to one or more, but not all, of the forms of shared tax arrangements are discussed in a subsequent section where the comparative merits of each form are evaluated.

1. Shared tax arrangements promote a high degree of co-ordination within the entire provincial-municipal tax field area. This tends to create simplicity through uniformity. As a result, the number of different types of tax variations are likely to be reduced. Conflicts and competition among the municipalities in imposing taxes are minimized. The area of geographic coverage of the resultant tax structure tends to be enlarged. This produces less economic distortion of the type that arises from the reaction of business firms to regional differences in tax costs. A grant system based on need and uniformity of services would cause still less distortion.

2. Shared tax arrangements eliminate the waste of duplicated collection costs. Independent municipal and provincial

administration of the same tax means that there will be some overlap and duplication in the collection machinery. There would have to be two sets of arrangements for each administrative function. This waste can be removed by employing only one administrator. Furthermore, this role could be performed by an experienced provincial organization that is already in existence.

3. Efficiency and economy of operation in tax administration can be increased by a provincial agency because of its larger and more comprehensive audit program. A significant gain from a better audit system is the potential reduction in evasion and avoidance of tax liability.

4. Taxpayers' compliance costs are lowered by a shared tax arrangement since usually fewer records have to be kept.

5. Regardless of its real value, the preservation of local autonomy seems desirable in the light of public opinion. All the forms of shared tax arrangements probably impinge upon local autonomy to a lesser extent than do grants in aid or shared expenditure programs. Even a mixed system composed of shared taxes and grants seems preferable to grants alone. Under even the most restrictive form of shared tax arrangement the local unit is given full independent power to decide at least how the funds will be spent. This type of independence could exist under a grant system only in very special circumstances.

The preceding argument loses some of its force if it can be demonstrated that taxpayer awareness does not exist at a level which differentiates grants from shared tax arrangements.

6. Shared tax arrangements, by their vary nature, suggest that the local unit will be given access to tax revenues that were previously denied to it. There may not be any legal restrictions on the use of a given tax, but administrative difficulties and costs may prohibit the municipality from taking advantage of it on its own. Shared tax arrangements enable the municipalities to widen their tax revenue horizons to include any tax that the province is capable of implementing.

7. The province's administrative costs of collecting its own taxes can be reduced. The municipality could be charged the average cost of administering the provincial and municipal taxes as a unit. This cost would likely be higher than the marginal cost incurred by adding the municipal tax to the province's collection program. Both the province and the municipality would gain from the lower costs. Even if the province's collection fee was set to cover only marginal costs, the province would probably gain from a lower average cost of collecting its own taxes since its administrative system would tend to approach the most efficient scale of operations. This latter point, however, assumes that the most efficient scale has not yet been reached.

8. There is something to be said for an arrangement which gives the province control, or at least direct knowledge, of the major part of the tax structure employed within the provincial-municipal sphere. The province is placed in a better position to map its own tax policy as well as give more knowledgeable advice on municipal tax affairs.

As with the evaluation of the advantages of shared tax arrangements, the following statements on their limitations are meant to apply to all forms of such arrangements as a group.

1. It appears inevitable that some local autonomy might be destroyed if a municipality switches from a locally imposed and administered tax to some form of shared tax arrangement. Some of the administration of municipal revenues will be removed from the hands of the local government under any form of shared tax system. Such dependence on the province is bound to lead to the loss of some control over the tax revenues. This drawback is of greater concern to the fiscally strong municipality than to the weak one.

2. Even in the cases where the distribution of tax revenues according to the place of collection is not difficult, the allocation may be grossly inequitable. It is easier to justify distribution based on the origin of the ultimate economic activity being taxed. For example, the distribution of sales tax revenues according to the place of sale would unduly favour

the market areas over the producing areas. It would be fairer to distribute tax collections according to the location of the purchaser. For example, the distribution of gasoline taxes according to the location of the bulk sales plants would be inequitable.

3. Shared tax arrangements ignore the fiscal needs of the municipalities. However, no tax system in itself can solve this problem. This is the function of equalization grants and other schemes. Shared taxes were never designed, nor should they be expected, to perform this function.

4. Looked at only from the point of view of the municipality, it is conceivable that the net revenue produced for the municipality could be higher with local administration than under a shared tax system. To begin with, the province may be satisified with a lower quality of tax administration than would be acceptable to the municipality. Furthermore, lower costs of administration at the provincial level may not necessarily be passed on to the municipalities. The state of Illinois, for example, started its scheme by charging its local governmental units a 6 per cent collection fee. Although it can hardly be argued that this type of situation is necessarily inherent to shared tax arrangements, it must not be overlooked that they have set the stage for such occurrences in the past.

The different forms of shared tax arrangements have their own particular merits and disadvantages. The following

comparative evaluation serves to identify some of them.

1. There appears to be a general recognition of the fact that locally imposed, provincially administered taxes lead to a great deal more financial responsibility on the part of municipalities than do supplementary rate or shared tax revenue arrangements. This is bound to be the consequence of any arrangement that gives a local government complete responsibility to design its own tax and at the same time places full power in the municipality's hands to decide when and if to use such a tax.

The supplementary rate arrangement likewise leaves sufficient discretion in the hands of local governments to guarantee a measure of financial responsibility. Since the municipality is responsible for deciding whether the tax will be used or not it is not likely to waste the funds received.

Since shared tax revenues may yield more revenue to some municipalities than they require, there is a danger that a tendency may exist to waste these excess funds. Shared tax revenues are much like "gifts" to the municipalities. This fiscal illusion tends to form a belief on the part of local governments that someone else is paying for their expenditures. This consequently tends to reduce any incentive to allocate and use the funds in the most efficient manner. This propensity toward financial laxity is further increased by the fact that local officials feel that they need not

account to taxpayers for all their decisions to spend.

2. The amount of local autonomy lost in designing a tax revenue structure is greatest with shared tax revenues and least with locally imposed, provincially administered taxes.

3. Compliance costs would tend to be greater for supplementary rates and locally imposed, provincially administered taxes than for shared tax revenues since the former are often not evenly spread geographically. Large firms doing business in more than one municipality, some of which do not employ the tax, would probably need to keep additional separate accounts.

4. Tax evasion would be less under shared tax revenues than under supplementary rates since geographic avoidance is impossible under shared revenues. The degree of evasion of tax liability under the locally imposed, provincially administered tax would depend a great deal upon the nature of the tax. The tax may be difficult to enforce even with efficient administration.

5. The ease of implementing a shared tax arrangement depends on the type of plan used. Shared revenue arrangements would be adopted with the least difficulty. The implementation of a locally imposed, provincially administered tax would require the greatest effort and would run into the most snags.

6. Local districts would tend to be at the mercy of provincial economic and fiscal policies to the greatest extent under

shared tax arrangements. Supplementary rate arrangements are not far removed from the same criticism, except that local governments always have the choice of optioning out of the scheme. Of the three forms of shared tax arrangements municpally imposed, provincially administered taxes are the least dependent on provincial policy decisions.

7. Compared to supplementary rates and shared tax revenues, locally imposed, provincially administered tax arrangements create the greatest opportunity for the pyramiding of tax rates. Quebec, for example, had by far the highest sales tax rate in Canada. The rates on the provincial level were superimposed over the rates on the municipal level. Whether such rates would increase to "intolerable" heights has to remain primarily a value judgement, except it must be remembered that marginal changes in a high rate structure tend to be of greater economic significane than equivalent absolute changes at lower rate levels. This means that even a "good" tax may be burdened to death by excessively high cumulative rates.

CHAPTER III SHARED INCOME, SALES AND VALUE-ADDED TAXES

Introduction

Since independent income, sales or value-added taxes of a purely local nature do not appear to be feasible, this chapter investigates the possibility of obtaining revenues from these sources through some form of provincial-municipal tax sharing arrangement.

The economic, equity and administrative criteria discussed in Agenda for Municipal Revenue Reform still apply to these taxes. The goal in this chapter is to evaluate: local imposition and provincial administration, supplementary tax rates, and the sharing of tax revenue.

Provincial-Municipal Income Tax Sharing

An acceptable approach to the use of local income taxes in Alberta would appear to be the procedure used in the Scandinavian countries; that is, collection in conjunction with the national income tax. The income taxes in these countries provide the major source of revenue to local governments. The rates used are higher than those used at the local level in the United States. The cities in Norway, for example, obtain over 90 per cent of their revenues from income taxes.

The province could obtain information from the federal government giving the location and the amount of taxes collected from each taxpayer within its boundaries. The province could then allocate some of the provincial income tax revenues to each municipality on the basis of the amounts collected within each municipality. If the province could not afford the depletion of its own current revenues from income taxes, it could negotiate for a higher supplementary rate with the federal government.

Shared revenue arrangements would function a great deal more effectively with the personal income tax than with the corporate income tax. It appears to be grossly unfair to distribute corporate income tax revenues according to the place of collection. Ideally, revenue should be allocated according to the location of the activity that generates the income. The complexity of economic interdependence generally prevalent makes this goal impossible to attain. At best, only a crude apportionment device can be used employing a limited number of indicators such as payrolls, sales, and property within each municipality. The formula used by the federal government to allocate the tax revenue among the provinces departs even further from the ideal. It is based equally on the destination of sales and the amount of wages and salaries paid by the corporation within the province, provided that the corporation has a permanent establishment in that province. For the allocation of corporate income tax revenue to municipalities it would appear desirable to include at least property

values in the formula in addition to sales and salaries. Property not only contributes to the creation of income but it is also responsible for a large portion of municipal expenditures. Municipalities would have no difficulty in measuring property values. Such information can be directly abstracted from the property tax assessment rolls.

Since the splitting of corporate income tax yields among municipalities would be exceedingly complex in an interdependent economy of any kind, the most practical solution may be to exclude the corporate income tax from the shared tax arrangements. The corporate income tax revenue could be distributed according to some equalization formula as a part of a scheme of shared revenues and grants. Not only would this solve the complex problem of revenue allocation but it would also remove a major complaint against shared revenues. It has been argued that shared revenues often provide an excess of funds to some municipalities and that this impairs the financial responsibility of local officials. This situation would be less likely to arise if the personal income tax revenues were shared and the corporate income tax revenues were used to provide equalization grants.

If the existing federal-provincial fiscal[9] agreements could be modified, then, in addition to shared revenues, the province would be empowered to suggest supplementary rates and/or municipally imposed, provincially administered tax schemes. Both of these arrangements introduce the possibility of relatively

more income tax revenues being collected in some areas than in others compared to the amounts collected under shared revenues. These differences would result from the fact that some municipalities may not be part of the scheme. Unequal collections may also arise from deliberate policy decisions. The province, for example, may decide that it will permit only the urban centres to become part of a supplementary rate scheme. This could well be the case since it appears that the financial requirements of cities are usually a great deal more urgent than those of local government in rural areas.

Under present circumstances it is difficult to envisage a municipally imposed, provincially administered income tax arrangement for most of the provinces. The provinces would have to go back to administering the income tax. This is not likely to happen. It is also hard to expect anyone to suffer the multiplicity of income tax structures that may develop under such a scheme. On the other hand, a supplementary rate scheme is a distinct possibility. Its appeal, compared to shared revenues, is that it need not be employed any more extensively than the respective revenue requirements of the various municipalities dictate. A supplementary rate scheme thus facilitates the policy problem of directing revenues where needed without introducing equalization grants. It provides the framework within which each municipality is enabled to gather enough tax revenues from its own resources, preserving local autonomy.

Municipal revenues from a shared income tax would depend on the form of shared tax arrangement used. If a shared revenue scheme was employed, the yield to any municipality would depend primarily upon the generosity of the provincial government; that is, the province could provide the municipalities with as much income tax revenues as it deemed desirable.

The yield from a municipally imposed, provincially administered income tax would depend upon the tax structure used and the tax rate levied. Theoretically, the municipality could set the structure and rates to yield any desired level of revenues.

The amounts of revenue received by using a supplementary rate superimposed upon the current federal personal income tax structure would be in direct proportion to either current collections of the federal income tax or to the amount of taxable income within the boundaries of each municipality.

There are two ways in which supplementary rates may be imposed. One method would be to set a supplementary rate that is based on taxable income. This method is usually described as the "tax on income" approach. If, for example, the rate was set at 2 per cent then the marginal rate on each taxable income class would be increased by 2 percentage points.

An alternative method of setting supplementary rates is to base the rate on the income tax payable rather than on taxable income. This is called the "tax on tax" approach.

The provinces currently receive income tax revenues by using this method. A comparison of the potential revenues for the City of Edmonton under the two methods of setting supplementary rates is given in Table 3-1.

A supplementary rate structure based on taxable income would yield a great deal more revenue per one per cent tax rate than a structure based on tax payable. However, supplementary rates based on taxable income are much less progressive than rates based on tax payable.

Provincial-Municipal Sales Tax Sharing

This section assumes that Alberta adopts a provincial retail sales tax. Any province could quite readily share a portion of its retail sales tax revenue with its municipalities. A fraction of the funds could be transferred to local governments according to the place of collection. The administrative problems are not unsurmountable. However, a shared revenue scheme creates a problem of equity. Sales tax collections concentrate in market areas at the expense of production areas. This means that rural residents would help finance urban centres. A municipality without a sales outlet would be without any sales tax revenue. Even if it could be argued that this is not undesirable from the point of view that rural residents should contriuute to the maintenance of urban facilities they use, the sharing of sales tax revenues according to the place of collection would have to

TABLE 3-1 ESTIMATED SUPPLEMENTARY TAX RATE REVENUES, EDMONTON, 1969, THOUSANDS OF DOLLARS

Taxable Income	$813,573
Tax Payable	201,746
Estimate Local Tax Revenue:	
1% of Taxable Income	8,136
1% of Tax Payable	2,017

Source: Department of National Revenue, Taxation Statistics, 1969, (Ottawa: Queen's Printer, 1971).

be viewed as a deliberate undertaking to favour urban centres at the expense of rural residents. Such a policy may be more easily defended than the method used to implement it. It may be that less obvious but more direct methods would lessen the degree of compromise needed between economic and political principles.

A supplementary rate arrangement has the same limitations as the shared revenue scheme. It is meaningless to suggest to a rural municipality that it may ask the provincial government to collect sales taxes within its boundaries if all or most of its residents do their purchasing elsewhere.

Locally imposed, provincially administered sales tax arrangements could be designed to remove the bias favouring urban centres by excluding sales to non-residents from the tax base. This "remedy", however, is not without its own problems. Witness the experience in the Province of Quebec. Compliance costs, audit costs, evasions and delivery costs were all higher. In fact, nearly all the limitations of a locally imposed and administered sales tax are re-introduced.

There appears to be no practical avenue for municipalities to raise revenue through local sales whether these are operated through tax sharing arrangements or run independently. The recent trend in the United States is from local administration to state administration to the elimination of

local sales taxes entirely. This is the route that was followed by Quebec and has since been copied by Mississippi and New Mexico. Other states are also now on the way toward eliminating local sales taxes.

Provincial-Municipal Value-Added Tax Sharing

The value-added tax could be considered for provincial-municipal tax sharing arrangements. Lindholm claims that a sales type of a value-added "permits the return of funds to geographical areas where they were collected."[1] This means, however, that such funds would accrue only to those localities fortunate enough to be centres of manufacturing, wholesaling and retailing activity. Inequities of the kind mentioned in discussing the local retail sales tax would still remain, but probably of a less serious nature.

Wages and salaries could be used as an acceptable approximation of local tax collections under either the sales type of income type of value-added tax. Papke suggests that this could be a more meaningful basis of distributing revenues from a value-added tax.[2]

The economic choices associated with the value-added tax are probably a great deal more marginal than the choices to be made on political and administrative grounds.

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[1]Lindholm, R.W., "Integrating a Federal Value Added Tax with State and Local Sales Levies", National Tax Journal, September 1971, p. 406.

[2]Papke, J.A., "Michigan's Value-Added Tax After Seven Years", National Tax Journal, December 1960, p. 414.

CHAPTER IV CORRECTING THE BENEFIT-COST IMBALANCE[1]

There is a clear awareness in Canada that governments are failing to provide adequate services at the local level. The Economic Council of Canada in one of its recent annual reports stated that we are faced with "a heavy backlog of essential improvements" at the local level. The need is felt most urgently in such areas as welfare, education, pollution, housing, poverty, social disturbances, traffic and confused land use.

The solutions do not lie merely in divising schemes whereby local governments are enabled to increase their ability to raise funds by the means discussed in the previous chapters. Nor can the blame be laid exclusively on the overburdened property tax, as is often done. The problem cuts much deeper. What is genuinely needed is a reassessment of the inter-governmental allocation of the responsibility for a significant segment of services traditionally provided by local governments.

Such a reassessment can best begin by first viewing the situation in its simplest form, as may exist in a perfect world. This means that the only limit to the production of goods and services used to satisfy all our wants would be the total amount of resources we have at our disposal. In this

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[1]Parts of this chapter are based on ideas previously appearing in "How Efficient Constitutional Reallocation of Governmental Finance Can Help Canada Solve Pressing Urban Problems", Civic Administration, October 1970.

perfect world all the goods and services would be distributed among individuals in a manner that insured the greater possible benefit to society as a whole.

In this perfect world goods and services would fall into two categories, those that are purely private in nature and all others. The all others would include those that are normally called government or public services.

Private goods and services provide benefits that accrue exclusively to individuals and nobody else obtains any benefit or satisfaction from these goods and services. Pure governmental goods and services, on the other hand, continue to provide benefits to all regardless of the amounts used or consumed by any single individual. Nobody is excluded from the benefits of pure governmental services. A good example of this is national defense. Everyone receives the same amount of service from our armed forces regardless of personal needs or taxes paid.

Benefits from governmental services can be subdivided geographically into local services, regional services, provincial services, national services and even international services.[2] Local services include such things as street lights. Street lights are governmental services because it is impossible for any one person to reduce the amount of light left to another person by making more use of it, and because the amount of light available to any single person is independent

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[2]Breton, A., "A Theory of Government Grants", Canadian Journal of Economics and Political Science, May 1965.

of the amount of taxes paid by him. Street lights are local governmental services because the benefits of the lights stop at the boundaries or at the last light post.

An example of a purely provincial governmental service is difficult to find. A highway used exclusively for intra-provincial traffic would be one. National defense can be used as an example of a national governmental service. The policing of armed conflicts by the United Nations is an example of an international governmental service.

In the real world the above classifications begin to break down because the benefits associated with any good or service are never really geographically exclusive. There exist, spillovers or neighbourhood effects or what economists call externalities associated with every service.

A very good illustration of a service that cuts across all lines is provided by education. For example, a university education bestows certain benefits directly upon the student, but at the same time others benefit as well. According to the Royal Commission on Taxation education enhances, "the quality of society" for the benefit of everybody. The more educated individuals there are in a city, the better off the members of that city will be; the more educated individuals in any province, the better off everyone in that province will be; and so on. Everybody in the world benefits to some extent from every other individual's education.

The ideal solution to financing a service such as education is to allocate that portion of the cost which represents the individual's personal benefit directly to the individual himself. The remainder would then be paid for by the different levels of government according to the external benefits created at each level. This would be the only way to insure that the right amount of the service would be provided.

Unfortunately, the real world gives us little help in either measuring any of these external benefits, or in comparing them to each other, or in assigning them to the proper jurisdictional levels of government. A further problem arises because today's distribution of responsibility between the different levels of government will most certainly be obsolete by tomorrow. Education, for example, may at one time have been primarily a private or local concern, but with the advance of communication and interchange of ideas and the growth of economic interdependence in our modern society, this is no longer true. Welfare and urban housing are other examples with evergrowing external social benefits. So are the control of air and water pollution. The list is increasing almost daily.

This continual geographic shift of external benefits calls for a constant review of our constitutional allocation of responsibilities. What we have experienced in recent years is not so much a disproportionate growth in local government responsibilities as a growth in responsibility for services that are not purely local in nature.

The current constitutional misallocation has a number of undesirable aspects. One of these is that local governments do not have any incentive to supply adequate amounts of services which bestow net social benefits primarily to those living outside their jurisdiction. The priorities of local politicians are bound to place greater emphasis on services which benefit primarily the local voters.

In all likelihood, if we were to adopt the approach of allocating the responsibility for different services according to the benefits received, there would be an increase in the amount of services normally available at the local level. Such increases would come from provincial and federal governments. The non-local portion of any governmental service should be paid for by provincial and/or federal taxpayers for the benefits they expect to receive. These taxpayers, through their elected representatives, can reserve the right to determine the nature of the service they are buying. This guarantees a more optimal use of our resources.

There are two technical problems of implementation, First, it is necessary to identify and measure the geographic distribution of benefits associated with the many urgently needed local services. Second, the correct level of government must be empowered to discharge the proper responsibilities assigned to it. If we are to get the services we want, some level of jurisdiction must always be solely accountable for each and every economic activity in our society. This requires

not only accepting the principle of changing our constitution but also the principle of subjecting it to periodic revision.

An analytical method for allocating the financial responsibility according to the benefits received by individuals and the different levels of government can be developed from a technique first used by Bowen in analysing the supply and demand for governmental services (or social goods).[3] According to this approach benefits arising from the externalties of any governmental service are reflected in the demand schedules of the respective beneficiaries. Education services can be used to demonstrate this principle.

As mentioned above, a given amount of education received by any individual bestows benefits upon that individual, primarily in the form of greater productivity (income earning capacity) and personal satisfaction. For these benefits the individual is prepared to pay a price. The lower the price the more education will be demanded. This can be illustrated by a demand curve for education for that individual as shown in Figure 4-1.

The municipal unit within which the educated individual resides also receives benefits from that individual's education, mostly from his higher income which increases tax receipts and lowers welfare payments. Should the individual decide to move away after obtaining his education all of these

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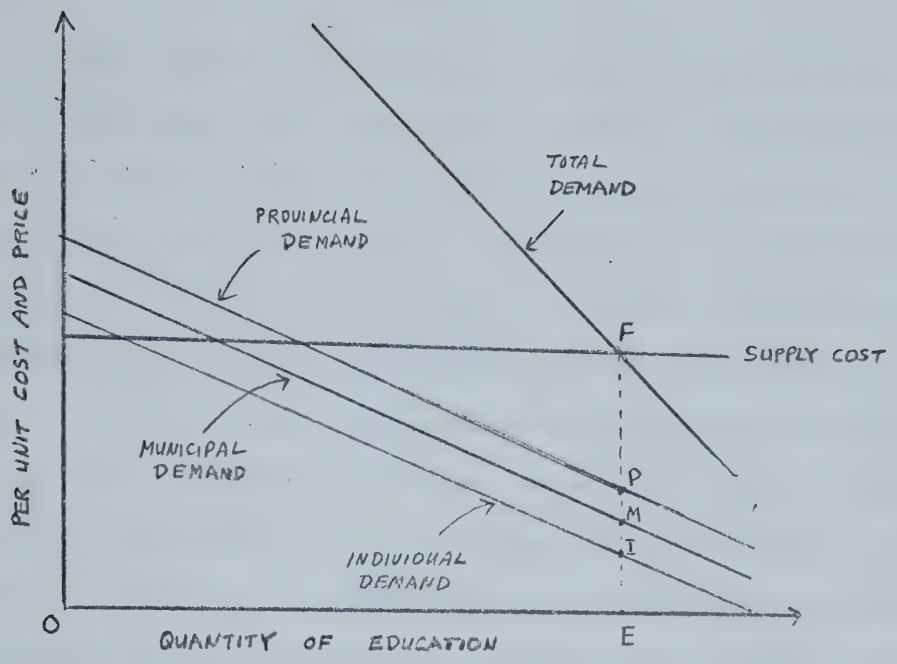
[3]Bowen, H.R., Toward Social Economy, (New York: Rinehart, 1948).

benefits would be lost to the local government. This possibility limits the extent to which any municipality would be prepared to finance the education of individuals. The net benefits to the municipal are represented by a demand curve as indicated in Figure 4-1.

The province also benefits from the individual's education through higher taxes and lower welfare costs. In addition, since the province does not lose any benefits when the individual decides to move from one community to another within the province, the province obtains a further benefit from educating that individual not available to each municipality separately. Only when educated individuals leave a province do costs exceed benefits for that province. The net demand for education by the province is shown in Figure 4-1.

Total demand for the education of an individual is the sum of the separate demands of all those who benefit from that individual's education. This is shown in Figure 4-1, where the demand curves of the individual, the municipality and the province are added vertically to arrive at total demand. Given a constant cost supply curve (assumed to take into account all social costs), a total quantity of OE of education will be demanded at a price of ET per unit to be paid for by all those who benefit from the education. The individual is willing to pay EI per unit; the municipality is willing to pay EM per unit; and the province is willing to pay EP per unit; and EI plus EM plus EP equals ET, the total price per unit.

FIGURE 4-1



Different types of education would yield different combinations of demand curves. For example, primary and secondary education benefits the local community relatively more than it benefits the individual or the province compared to the benefits received from post-secondary education. The province and individuals are prepared to contribute a larger share for university education than for primary and secondary education.

Certain trade education benefits primarily the individual, in which case the training costs get little governmental support at either level. On the other hand, education designed to train individuals to work in a unique industry located in a single municipality would benefit that municipality almost exclusively.

The greater the benefits received the greater the share of the costs that would be allocated to the beneficiary, and the greater would be the right to decide the type of education the individual gets. For example, an individual accepts the prescribed curriculum in primary and secondary education as set by the government paying for it without question. On the other hand, since university education benefits the individual relatively more and since he pays more for it, the individual has a greater say in the type of education he receives. The individual expresses his preferences by deciding which university to attend, which faculty to enter, and which courses to take. Universities, faculties and individual courses expand or contract according to the decisions of the individual.

Similar processes are involved between the different levels of government, each accepting and discharging its rights and responsibilities according to the benefits received. However, whenever the constitution prevents this type of matching of financial and program responsibilities, as occurs quite often at the federal-provincial level, a less efficient solution must be accepted. In Canada, the second-best solution accepted appears to be conditional grants or grants-in-aid. As George E. Carter claims,

> "to ensure the desired increase in the provision of public services that generate benefit spill-outs, the federal government must make grants to the jurisdictions supplying such services. The appropriate device

... is the conditional grant-in-aid."[4]

This statement, to some extent, is misleading in that it implies that conditional grants are the "best" solution. One of the strongest advocates of conditional grants in the United States, George F. Break, argues quite forcefully that "unconditional grants represent a second-best solution to ... intergovernmental fiscal problems."[5]

The issue of whether conditional grants are second-best or not is crucial when the discussion shifts from federal-provincial to provincial-municipal fiscal problems. At the federal-provincial level the best solution is to change the constitution. Since this is a slow and uncertain process, conditional grants can be used as a short run interim response to resolving some of the federal-provincial fiscal problems. At the provincial-municipal level, however, there is no need to accept this second-best approach. There are no real constraints on re-allocating provincial and municipal responsibilities within the province.

Grants preclude careful foreward planning, they only provide a patchwork response whenever a crisis occurs. Grants create an atmosphere of something for nothing and lead

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[4]Carter, G.E., Canadian Conditional Grants since World War II, (Toronto: Canadian Tax Foundation, 1971), pp. 12-13.

[5]Break, G.F., "Revenue Sharing: Its Implications for Present and Future Intergovernmental Fiscal Systems: The Case For", National Tax Journal, September 1971, p. 307.

only to bickering among the recipients and between the grantor and the grantee. Principles give way to political power games. A former chairman of the Council of Economic Advisor to the President of the United States described the use of grants as,

> "utterly unwise in terms of the relative priorities of urgent economic and social needs; thoroughly unsound in terms of sheer economic analysis and policy; and a dangerous departure from responsible governmental practise."[6]

This echoes the concern expressed at the 1972 meeting of finance ministers in Jasper.

Offering grants is often accepted as "at least doing something about the problem". However, such action only diverts attention from more "urgent forms of action, by creating a spurious atmosphere of movement and inventiveness."[7]

George E. Carter catalogued the many dissatisfactions with the use of conditional grants in Canada. Among the complaints were the following.[8]

1. Costly programs are abruptly abandoned distorting planning processes.

2. There is insufficient federal-provincial consultation leading to bitter controversy.

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[6]Keyserling, L.H., "Revenue Sharing: Its Implications for Present and Future Intergovernmental Fiscal Systems: The Case Against", National Tax Journal, September 1971, p. 313.

[7]Ibid., p. 317.

[8]Carter, G.E., op. cit., pp. 105-107.

3. The type and amount of federal control and supervision was subject to criticism.

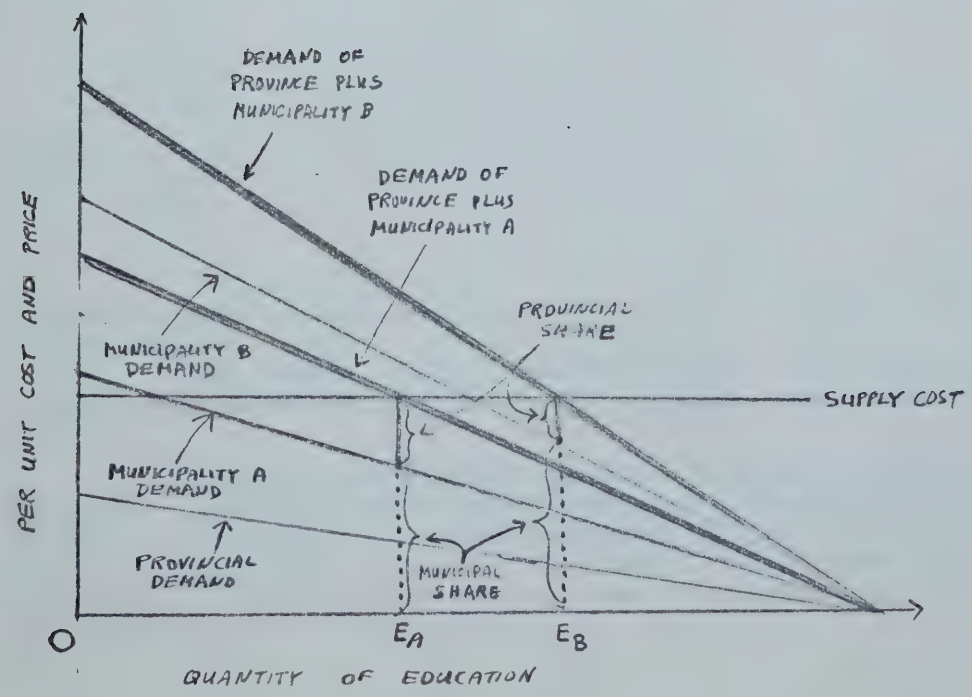
4. Disputes arose as to exactly what costs were sharable.

5. The matching formulas that were used met with criticism on several issues, particularly on their implicit equalization.

6. Too many different types of specific grants were introduced.

According to Figure 4-1, if education was supplied by the local government, the individual would pay a tuition fee of EI and the province would pay a grant to the municipality of EP. Figure 4-2 concentrates on the municipalities and the province only, and illustrates the consequences of grants whenever different municipalities have different demands

FIGURE 4-2



for education. Municipality A, with a lower demand, would receive a larger percentage matching grant than municipality B, if grants were to match the benefits received by the province. This creates not only the problem of different matching grants for different municipalities, but it also implies a policy that is in direct conflict with accepted criteria. If municipality A's lower demand results from lower fiscal capacity then the "equalizing" aspect of the grant is welcomed. However, if the lower demand represents lower fiscal effort than the grant would reward such reduced effort.[9] On the other hand, if the grants were kept at a constant matching rate, this would not solve the benefit-cost imbalance.

There is no substitute for re-allocating responsibilities between the province and its municipalities.[10]

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[9] See Wilde, J.A., "Grants-in-Aid: The Analytics of Design and Response", National Tax Journal, June 1971.

[10] Grants-in-aid that specify all the conditions under which the funds are to be spent cannot be legitimately classified as grants. In such a case the responsibility for the program and its financing is fully in the hands of the province, the municipality would be acting only as an administrative agent of the province.

CHAPTER V AGENDA FOR PROVINCIAL-MUNICIPAL FISCAL REFORM

Provincial-Municipal Arrangements

Among the three types of provincial-municipal tax sharing arrangements (locally imposed and provincially administered, supplementary tax rates and shares revenues) and the three forms of general taxes discussed in Chapter III (income, sales and value-added), the most efficient and equitable is the supplementary rate municipal income tax.

The income tax is considerably more equitable than any other ability-to-pay tax, making it an excellent substitute for a portion of the municipal property tax. In addition, the income tax is very productive of revenue. For example, a one per cent supplementary rate levied on personal taxable income in Edmonton in 1969 would have yielded substantially more revenue than an additional 10 mill levy on property.

Tax Integration

A supplementary rate local personal income tax also presents a good opportunity for partial integration of the property and income tax. The property tax improvements recommended in the companion submission,[1] Agenda for Municipal Revenue Reform, can be further extended by tying property tax

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[1]Salyzyn, V., Agenda for Municipal Revenue Reform, A Submission to M.L.A. Task Force on Provincial-Municipal Financing, Government of Alberta, (Edmonton, 1972), p. 113.

payments to the income tax. For example, the amount of income tax payable to the municipality could be credited for property taxes paid. The credit could be designed to vary with the amount of taxable income (or income tax payable) and the amount of assessed property.

A clear distinction must be made between the integration of taxes existing at the municipal level on the one hand and the expenditures made by the provincial government on such things as homeowner grants on the other. The former device can be used to manipulate or adjust the overall municipal tax base (or the overall tax rate structure) in a manner which guarantees that only those who possess ability to pay in some form or receive benefits are required to pay taxes. Only in this way a truly fair tax system be devised.

Provincial grants given in aid of the elderly or the poor should not be restricted arbitrarily only to those who pay property taxes. There is a distinct danger that the currently misguided popularity of provincial tax credits for municipal taxpayers may be permitted to develop into a substitute for legitimate aid to the needy. In the words of Keyserling, "a spurious atmosphere of movement and inventiveness" is created that diverts attention from "urgent forms of action".[2] There is no need to compromise the principles of fair taxation with any of the other legitimate concerns of our society. The only criteria

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[2]See footnote 6, page 47.

for aid to the elderly should be the age of the recipients, and the only criteria for aid to the poor should be the degree of poverty. The poor need aid equally as much to enable them to buy groceries as to pay property taxes.

Provincial tax credits given to municipal taxpayers distort the responsibility and benefit-cost balances and indirectly contribute to fiscal inefficiency.

A supplementary rate municipal income tax, whether integrated with the property tax or not, would help to solve responsibility and capacity-obligation imbalances and increase fiscal efficiency by reducing the use of the property tax, by minimizing the need for grants, by improving the overall revenue structure, and by coordinating taxes with the province (see Table 1-1, page 8).

Re-allocation of Responsibilities

By far the most urgent reform lies in the re-arrangement of responsibilities between the province and the municipalities in order to restore a proper balance between the benefits and the costs of all public services. There is a need to shift those responsibilities (both the programs and their financing) that generate substantial externalities beyond municipal boundaries to the provincial government. The areas of health, welfare and education offer good examples of this.

Such transfers would remove one of the most important causes of capacity-obligation imbalances, and solve the benefit-cost imbalance directly. In addition, the side benefit of reducing the use of grants cannot be overemphasized.

Agenda for Provincial-Municipal Fiscal Reform

1. Set up a supplementary rate municipal personal income tax with the province to reduce the role of the property tax.
2. Integrate the property tax with the municipal income tax to increase equity.
3. Remove provincial tax credits given to municipal taxpayers.
4. Shift more of the responsibilities for health, welfare and education to the provincial government.
5. Reduce the use of grants.

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